THE ECONOMIC BASIS FOR BUSINESS REGULATION

I. *The tendency to combination.*

The phrase "affected with a public interest" appears very commonly in American court opinions; out of it arise the controls of business, both quasi-public and private, that constitute the state's protection of the economic interests of the public. These forms of prescription are necessary because of economic illness. We cannot here discuss the symptoms which lead to the administering of one rather than another form of legal surveillance; it must be sufficient to point out that both prices and standards of service are regulated. But it may be noted that public utility regulations are positive and compulsory and regulations of private business merely negative and prohibitive. The phrase is the statement of a business condition in which it seems necessary for the state to protect the interests of consumers.

There are those who do not concur that this economic regulation is really remedial; they justify their dissent on the grounds that business is more prosperous and that the interests of consumers are sufficiently protected by competition. And when it is pointed out that in many businesses competition is not present as a matter of fact, they still contend that potential competition is a sufficient safeguard, that if prices rise too high or service standards sink too low, some one will perceive these conditions and offer better service at the old price or equal service at a lower price and that this will always happen. It is a kind of law.

But it would seem plain enough that only under conditions of perfectly free competition will producers allow the actual market supply of goods and services to coincide with the supply it is possible to bring into the market.

For the present we may identify "producers" with "sellers" for the producer must also dispose of his goods and become a seller; and it is in his selling and not his producing nature that those traits are found which make it necessary to institute controls that favor the consumers of his products. In his rôle as a seller he exhibits a set of dispositions entirely inutile—perhaps even pernicious—to him as a producer; so that the situation is covered, however disagreeable its implied ethics may be, by saying that the whole interest of sellers, as sellers only, is in the highest possible net profit. While he is actuated by purely acquisitive motives it is the constant effort of the business manager to control supply so that he may control one of the elements of the price equilibrium.

If the business manager in his rôle as salesman is able to dominate his business organization so that its policy is directed toward the control of supply; and if it does actually restrict supply, even in the

slightest degree, the normal result is that the price rises and profits are greater. It will be objected that there is a limit to this and that the business may find its sales so restricted by the higher price that its profits are reduced instead of augmented; this of course may happen, but it may not; and the fact that a business has the power to experiment thus with the machinery of the market is sufficient indication of the need of control. Furthermore, it is just this limitation of the supply of necessities that may cause the great harm to the public interest. It may be true that the business gained nothing from the restriction of the supply; but this fact does not absolve it from the charge of having harmed the public interest if it has reduced the supply of those things upon which people depend for their sustenance and happiness. So that even the most orthodox *laissez faire* believer, who would trust fully to the benevolence of freely competing forces and who feels that economic justice is to be expected to eventuate most often from their operation, has come to accept the real logic of the saying that, when competition is not free and when supply is limited in the interest of total net profit, there is a harm to consumers.

This point is made clear by Professor Clay who remarks that the essence of competition is in "the possession of an alternative and the exercise of choice by one party to the contract of sale; monopoly is the abolition of the alternative and power of choice."[1] And in another standard text book of economics[2] the situation just commented on is characterized by saying that the law regards competition as one of the main pillars of our present social order because it is so apparent that competing producers cannot increase profits (at the expense of consumers) by limiting supply. This same passage goes on to describe the reaction of the monopolist to his new-found power when he is freed from the restrictions of competition: "The monopolist will normally endeavor to fix his output at such a point that, given the existing state of demand, he will *secure the highest possible net returns*."[3]

John Stuart Mill, in saying that "neither law nor opinion should prevent an operation beneficial to the public from being attended with as much private advantage as is compatible with full and free competion,"[4] would, by implication, not deny that legal regulation ought to be invoked when the advantage to one party of a business transaction is not determined by "full and free competition" but by monopoly in some degree.

President Hadley remarked: "There can, I think, be no reasonable

[1] Henry Clay, *Economics for the General Reader,* p. 263.

[2] Ely, *Outlines of Economics,* ch. XII.

[3] *Ibid.,* p. 201.

[4] John Stuart Mill, *Principles of Economics* (Ashley ed.), p. 709.

doubt that the world is far better served under this competitive system than under any other system of industrial regulation which has hitherto been tried. The effect has been so marked that modern law—the English first and the continental afterward—has gradually adjusted itself to the conception that prices should be let alone wherever competition can regulate them; that a price obtained in open market, without fraud or artificial monopoly, is *ipso facto* a fair price. . . ."[5] But here again there arises a question of fact as to the existence of the "open market." The inescapable conclusion is that a price fair to consumers cannot be reached where there is not perfect and free competition; and that when the business situation which once justified the basing of legal principles on the economics of free competition has passed, the law ought to be changed to take account of the new situation.

We may restate our first conclusion, reiterated again and again by economists, that monopolists, by their control of the supply, may control price.[6] If competition were perfectly free such a situation could not possibly arise. But businesses important enough to be regulated are in their very nature businesses operating under conditions of decreasing costs. "The greater the extent to which plant and machinery can be used, the more concentrated the industry and the smaller the area on which a given volume of production can be turned out, the more probable is the tendency to lessening cost and increasing return."[7] This is a situation more likely to be true in such standard, stable, every-day goods and services as are likely to be designated for regulation (under the phase of the general police power which protects the economic interests of the public as contrasted with its interests in health, safety, morals, and order)[8] than in any other sort of business imaginable. And in such businesses the economic motive is best realized by extending sales and accepting low profits per unit in the interest of the large total profits remaining when total expenses are subtracted from total receipts.

The managers of these classes of business do not always apprehend that their acquisitive interest may be served by rate-fixing bodies which force them against their desires into large-scale service and the taking of a small profit per unit. But such is the reality of things.[9]

5 A. T. Hadley, *Freedom and Responsibility,* p. 117.

6 Taussig, *Principles of Economics,* vol. I, p. 199, for instance: "A monopolized commodity will be sold, by a person doing business for gain, on such terms as will yield the largest net revenue."

7 *Ibid.,* p. 191.

8 For a discussion of these phases of the police power see Ernst Freund, *The Police Power,* in the *Cyclopaedia of American Government,* p. 706 ff.

9 *Ibid.,* vol. II, p. 110: "Increasing returns in the strict economic sense are a usual characteristic of these industries."

Another element to be considered, however, is the elasticity or inelasticity of demand, which, in the case of necessities such as are likely to be regulated, operates in general to strengthen the desire of business managers for higher rates, offsetting the gains to be made by the decreasing costs of larger outputs. The demand is a highly inelastic one until rates are very much reduced, when a great strengthening of demand is felt. The curve of elasticity would fall off sharply in its upper reaches in the case of any necessity but would tend to flatten out lower down in the scale. "The consumers' demand (for necessities) tends to be inelastic. But as the most imperative needs are met his demand for more of any commodity acquires a greater degree of elasticity."[10]

It might seem desirable to the business seeking only the highest possible net returns to meet only this inelastic demand of the more well-to-do customers and not to reduce rates to the point where large numbers of purchasers would be called into the market as the curve flattened out and new classes of consumers were brought in under the influence of a much reduced rate. It is just this reluctance to make sharp reductions, call in large numbers of new purchasers and accept low per unit profits which justifies regulation.

Total profits of the business need not be less with wise regulation; but they will be gained by low per unit profits rather than high per unit profits on greatly restricted sales. The public interest in the wide dissemination of the product of the business at a low price is thus served and at the same time the business need not in the least be injured. Of course, the regulating body may, by design, cut into and eliminate a part of the net return earned by reductions in price and large consequent sales, but it need not if its main purpose is only to secure the public right to lowered rates and to hold business to its duty to serve efficiently.

In businesses with a tendency to increasing returns or decreasing costs coupled with an inelastic demand for the product, combination of competing units is in the long run inevitable, if for no other reason, simply because of the economies to be gained by operations on a large scale and the losses from plant duplication. But there is another reason, equally compelling, for the coming in of combination—the fact that combination, because combinations control supply, makes price control possible and frees the business manager from price competition.

In any case, in the business of supplying necessities to the public, combination is, in the nature of things, to be expected; and when there is combination there is a lessening of competition to the extent of the coming in of combination. If combination is purely to take advantage of large-scale economies, price will be very materially reduced by the

10 William E. Weld, *India's Demand for Transportation.*

business's own volition. But if, at any time, the business should stop its movement toward expansion and the continual reduction of price which brings in new purchasers, and should use the power it possesses over price, the public may well be, as the courts put it, "oppressed."[11] Where the one force causes combination the other may enter; and the full effects of the economies of large-scale business are, therefore, not necessarily passed on to consumers unless there is a consumers' control of the business.

II. *The conflict of interests.*

The economic interest of the business manager consists in the largest possible net return on the investment of the business; the interest of consumers consists in the cheapest and widest dissemination of goods[12] possible. The conflict between these interests is apparent in the stating. But it is often said that the business manager, in seeking the highest net return for his business, at the same time, though incidentally, secures the wide and cheap dissemination of goods and services desired by the consumer. As he moves in the service of his own interest, does the producer also serve the interest of the consumer?

The answer to this question seems to lie in the theoretical discussion of the mechanism by which the business secures the highest net return for itself—limitation of supply. When supply is limited, the demand for the good or service must adjust itself to the supply through the price equation. A limited supply means higher prices; and higher prices mean a restriction in use. If there were free competition this could not be true. Supplies would be furnished to meet the demand at a price which covered the cost of production with a small margin of profit. And as demand expanded and production increased, the cost of production would fall and prices would be driven lower by competition. With free competition there would be no restriction of supply and no raised prices; with combination these things are possible.

With the inevitable tendency to combination under the influence of decreasing costs, it seems almost as inevitable that there should be a control of prices that harms the consumer. It is inherent in the very nature of modern business. And there is a separation, therefore, of the interests of producer and consumer—that is to say of seller and buyer. With an "open market," free bargaining and no restriction or manipulation, both parties to a bargain normally benefit because one wants what the other possesses and willingly gives up something for it which is desired (or which represents something desired) by the other party to the bargain. The only compulsion is this mutual inclination of each

11 *Ratcliff* v. *Union Stockyards Co.*, 74 Kans. 1.

12 Goods used in this sense include services.

for the property of the other. But when markets are not open and bargaining is not free, one party to the business contract gains something at the other's expense.

Perfectly free competition and complete monopoly are equally rare phenomena; neither is descriptive of most business situations. But the tendency to decreasing costs as production is enlarged leads to combination for the pupose of effecting the economies of large scale business. In the pursuit of these economies a partial control of supply may give the business an incidental power over price. There is nothing to prevent the combination which gained its power legitimately enough in the lowering of production expense per unit, from using it for another purpose—the restriction of supplies and the control of price—thus securing to itself gains at the expense of the actual and potential consumers of its product.

If the question should arise: why is it necessary to secure a wide and cheap dissemination of the goods and services generally thought of as necessities, it need only be stated in answer that these goods and services furnish the materials of the environment in which children grow and in which men and women live, that our conduct toward one another and toward the groups in which we live is fundamentally affected by the state of bodily and spiritual nourishment to which we have been adjusted and in which we now find ourselves. The importance of goods and services of this necessitous character can hardly be exaggerated. The problems of the conflict of interests in the market are important not alone to the persons directly concerned, but to all of us. And this is not alone because we, like others, cannot escape the common needs and desires which compel us to use the same goods and the same services as other men, but also because, even though we may not suffer because of economic disadvantage, we still cannot avoid living in the same communities with those who do and in the long run cannot escape a common responsibility for the social arrangements which make possible the exploitation of consumers by the purveyors of necessities.

When the market is viewed as a social mechanism rather than as a private one, and the reasons why it must be social and cannot be private are clearly envisaged, the problems of price and service control attain a new importance. Consider, for instance, the relationship of the price-fixing process to the income (the real income in the satisfactions got from using goods and services) of the persons in the community. One of the fundamental reasons for the stressing of that phase of economics which has to do with the apportionment of income, has to do with men's struggles to provide themselves with more generous quantities of goods and services. But this can never be successful so far as higher wages are concerned, for instance, so long as higher wages are thought of as

increasing the expenses of production and as an incentive to the managers of business to use whatever monopoly powers they possess to raise prices. The struggle is futile. No more of the satisfactions of life come out of it for the wage workers. But when the problem is attacked with the idea of restoring the consumers' power in bargaining, a beginning has been made in securing to men as consumers more generous supplies of those satisfaction-yielding goods about which, in reality, the whole industrial struggle revolves.

The controls which arise under the conception of the existence of a public interest in business transactions, are, in reality, economic weapons of the consumers, though the results are achieved through the agency of the theoretically impartial state. It is conceived by some persons that, by such interference in the interest of consumers, the state violates its rule of impartiality; but this view identifies impartiality with inactivity. To be impartial in this case the state must act. There is a separation of the interests of producers and consumers; the institution of public controls is a recognition of this conflict of tendencies and a way of protecting the right of consumers to a certain standard of living.

The courts have moved steadily in this direction. A long list of businesses formerly private have become public utilities under the common law; and the courts have shown a disposition to permit regulations of businesses by legislative statute under the police power to a greater and greater extent. There is some evidence that the courts have felt themselves running counter to accepted economic opinion, which they took to be *laissez faire;* and there is some defiance in their attitudes as they have extended the scope of market interference. It may be seen, for instance, in Judge Pound's words:

"*While in theory it may be said that the building of houses is not a monopolistic privilege; that houses are not public utilities like railroads and that if the landlord turns one off another may take him in; that rents are fixed by economic rules and the market value is a reasonable value;* that people often move from one city to another to secure better advantages; that no one is compelled to have a home in New York; that no crisis exists; that to call the legislation an exercise of the police power when it is plainly a taking of private property for private use without compensation is a mere transfer of labels which does not affect the nature of the legislation, *yet the legislature has found that in practice the state of demand and supply is at present abnormal; that no one builds because it is unprofitable to build; that there are those who seek the uttermost farthing from those who choose to live in New York and pay for the privilege rather than go elsewhere; and that profiteering and oppression have become general. It is with this condition and*

not with economic theory that the state has to deal in the existing emergency."[13]

Such constraint could only arise from the conception that economic theory has nothing to do with such facts as Judge Pound cites. It happens, however, that economic theory is broad enough to include monopoly as well as *laissez faire* and to account for its effects in the market. Economists know there is a separation of interests; and that monopoly powers may be exercised to the harm of consumers; and they know too that the application of the remedy would be more clearly understood if the economic principles really involved in regulation were more widely apprehended. It is the modern tendency toward combination, toward larger-scale business, under the compulsion of the principle of decreasing costs—and the use of the power thus gained for exploitative purposes that poses the problem of control. And the purpose of control, therefore, is to remove this possibility of exploitation. It is not, as some imagine, to interfere with the tendency toward combination which may be set down as inevitable; but merely to make sure that a power gained adventitiously by business is not used to the detriment of those whom the business serves.

III. *The discovery of monopoly.*

The disadvantage of consumers in dealing with the purveyors of the goods and services they need gives rise to what the courts call the public interest in business; this appears from the analysis of the conflict of interests in the market. And the cause of this economic harm to consumers lies in the influence of monopoly upon price. But whether there is monopoly in a market, with its concomitants of restriction of supply and control of price, cannot be determined by investigation of less than the whole of a market situation. By this it is meant that investigations of business units as such cannot reveal the presence of monopoly unless the relations of the business to the whole of the market can be revealed. By looking at the business itself a judgment of its monopoly powers cannot be arrived at. The total need for the good or service, the total possible and actual supply of it, and the part the particular business plays in the whole process is the only possible basis for judgment.

Legal preoccupation has usually been with single business units because cases often come before the courts in that way. It is said that this or that business is a monopoly and suit is brought against it. The judicial opinion has to do with the particular business in question. This is one reason for the failure of the anti-trust acts to secure the public

[13] *People ex rel Durham Realty Corp. v. La Fetra:* from a transcript of the original opinion of Judge Pound. (Italics are the author's.)

interest in business. It has been assumed that only if a business was big enough actually to monopolize or if a conspiracy between business units could be proved was there sufficient reason for public action; and even then action could be only repressive.

There is a different theory altogether implied in regulation under the police power and under public utility law as it has come to be applied under the rule of the phrase "affected with a public interest." And, indeed, the way of regulation, if it is really to secure the public interest, should not be the way of dissolution and suppression of particular organizations engaged in business. The good or service should be the basis for regulation. The sovereign state should be perfectly impersonal toward the business unit. It should remember that what the public interest demands is the wide dissemination and the cheap availability of necessities. And the means of regulation to secure this public interest are to this end and not to the end of breaking up some really serviceable business unit engaged in dealing in the good or service. The part the business plays will only be touched in following up the stream to its source. And there may be more than one source.

Confusion of the business with the function it serves has made a difference in our theory. It is the business that has been stressed; it is the function that ought to have been stressed. Production is organized fundamentally about the supplying of the needs of society; regulation is interested also in the free flow of the instruments which meet these needs. It is not, except incidentally, interested in the persons or organizations that supply them.

Suppose an investigation of the supplies of a certain necessity suspected of having been monopolized; suppose also a monopoly situation to be suspected because of strange rises in the price or sudden shortages in the supply of it; suppose further that there are found within a given market five businesses supplying it. The investigating body concerned with regulation goes to each business in turn and investigates thoroughly its processes and methods. Nothing irregular is discovered. May it therefore be concluded that there is no monopolization of the product? No restriction of supply? No control of price? There is no monopoly. But that the product is monopolized appears from the movements of the price of the product.

One definition of monopoly is: ". . . single-handed control over the total supply."[14] But this kind of monopoly has been shown by investigation not to be present. Is there another type of monopoly?

There is, for instance, this one: "Absolute monopolies are those in which, by law or ownership of all the sources of supply, the holder's control is complete. Industrial monopolies are those in which the con-

[14] Taussig, *Principles of Economics*, vol. II, p. 107.

trol over the supply, while not complete, is yet effective enough to bring about a state of things different from that of competition, in which, even though there be no legal or natural restriction, the nature of the operations is such that competition is wholly removed, or operative only to a limited degree."[15]

Here is a definition of monopoly that may take account of our supposed situation. One of the five businesses may control such a preponderance of the supply that the others will submit tacitly to its leadership; there may be a gentlemen's understanding, wholly without conspiracy. Either of these or any one of many other ways may have been taken to gain the result.

But for the justification of regulation, if its justification lies in a harm to the public interest, there need be no conformity of the monopoly to any definition. The essential thing is the emergent effect on prices and standards of service. Monopoly begins to explain price as soon as there is any restriction of competition whatever from any cause; and when there is restriction the law of competitive price ceases to be of value as an explanation.

The harm to consumers arises out of a separation of interests and a power of sellers over prices; it begins to appear whenever there is any monopoly influence on prices. Taussig calls this "industrial" monopoly. There are reasons why this is not a really descriptive term; but they need not be discussed here. The important thing for the present purpose is to see that consumers may be harmed in their economic interest by agencies amenable to no other controls than those being imposed under the rule of their classification as "affected with a public interest."

IV. *The power of substitution.*

It might very well be argued, and often is, that the consumer has another defense than public regulation, one much more easily brought into play and involving no expensive and bothersome interference with business—the power of substitution. If the prices of goods and services rise too high, it might be said, there are a great variety of others; and these others may even be less costly. Why not substitute?

This may often be done, it is true; and sometimes consumers are not only as well off for the change but actually better off. Instances are plentiful. The expense of providing meat for the family table has risen greatly in recent years and foods have been substituted which have a better physiological effect and are cheaper. Meat was necessary in the diet of out-door workers; it is much less necessary in more sedentary factory occupations. Here was a case where a clear gain resulted from

[15] *Ibid.*, vol. II, p. 107.

the substitution process. But there seems to be no guarantee that such a gain will result in every case. Nor, when artificial control of price enters, is there any indication in the price curve of the exhaustion of resources or of other basic reasons why consuming habits ought to be forced to a change. If rising prices were a sure indication that land of a less productive sort is being forced into use to supply our appetites and that it is becoming more difficult to produce because of the obstructions placed in the way by nature, then the rise in price would be doing a service in forcing many people to turn wholly or in part to other sources of satisfaction. But when price merely represents an arbitrary limitation of supply, a conscious withholding from the market, it does not measure, as it otherwise would, any decline in production advantage. It has nothing to do with the niggardliness of nature.

There seems to be no defensible reason why consumption habits should be compelled to change so that some one, or even a group of persons, may gain a profit. The power of substitution is a real weapon of man against the parsimonies of earth; but in a well-organized social group, consumers, it would seem by any canons of ethics, ought not to be left without other recourse than this against the artificial manipulations of prices which are a part of the executive scheme of modern businesses.

We may inquire what are the limitations within which consumers may invoke the power of substitution harmlessly. When dietitians agree that milk is a necessity for growing children and that there is no effective substitute known, we may presume that there would be a positive harm in the substitution for milk of other food materials. Likewise when the family kitchen is equipped with facilities for cooking with gas, there is a harm in invoking the power of substitution against high rates for gas and turning to coal or electric ranges. It involves expensive re-equipment of the domestic plant—so expensive that a gas company might figure on a very little less use of gas with some slight increase in rates. When one is compelled to go on a journey, there is no really good substitute for the railway train which runs directly to the destination. There are reasons why substitution, though in many cases a real and effective weapon, ought not to be used as an instrument by consumers in coercing the purveyors of necessities. Certain limits designate themselves: they may be formulated somewhat as follows:

1. *The limit set by the natural productivity of the region of the market.* Society ought not, by reason of artificial limitation of supply, to be forced to substitute for the materials nature assists us most in producing, those which she assists us less in producing.

2. *The limit set by the state of the industrial arts.* Comparable with the limitations fixed by nature are those set by our state of advance-

ment in civilization. In fact we have come so far in productive efficiency and no farther. By reason of humanly restricted supplies we ought not to have to choose things produced under such difficult conditions of technique as would add to their expense.

3. *The limit set by expert definition of what is desirable in the circumstances in which we find ourselves.* If fresh eggs are prescribed by the physician for the invalid, or milk for children by the dietitian, or a certain number of cubic feet of air space per individual by the housing expert, substitution ought not to be invoked to change the reasoned judgment of the expert in these definite social adjustments.

But if, as a part of the nature of our developing economic system, there is this control of supplies and consequent increase of prices when the consumer is under rigorous compulsion to buy, the power of substitution, however harmful in the long run, would necessarily have to be resorted to if there did not exist as a remedy the power of the state to regulate business in the interest of the economic welfare of its citizens. The conditions we have described create a public interest in the business. The courts will recognize as valid a legislative statute fixing prices or regulating service in such a business; or, if the business can be shown to possess certain likenesses to other businesses already public utilities, it may be regulated under the common law without legislative statute, simply by a case being brought in the courts, and judicial recognition of the nature of the business being gained. This, however, is a rare modern procedure. For the most part, regulations are made by legislative authority under the economic interest phase of the police power.

V. *The difficulties of regulation.*

It has been one objection to the regulation of business that the difficulties encountered are so great as to make the expense of regulation greater than the savings to consumers. Whether or not this is so, there is a great deal of regulation under way; enough so that it is clearly a part of our politico-economic system. And the nature of the difficulties encountered may be analyzed.

The price-fixing body, if it is not to incur the penalties for the disregard of economic forces, must, in practice, calculate the necessary or desirable supply first and then proceed to the fixing of a price which will bring in that producer whom economists call marginal—the producer who rounds out the supply: this supposing there is more than one producer in the single market. If there be but one producer a price must be allowed which will still cover the expenses of production of the dearest portion of the supply. If all of it is produced under the same conditions, the expense of producing every unit will be the same;

but if there are, for instance, a number of plants and the output of all of them is needed, it will be necessary to fix a price which will cover the expenses of production for the goods turned out by the least efficient of them. And this is a true instance in the sense that it illustrates the lack of uniformity in conditions of production. No two plants are quite alike; no two firms operate under quite the same advantages or difficulties. But it is the least efficient plant, the firm with the greatest difficulties, which fixes the price that must be allowed. This is so because the part of the supply produced in this way is needed quite as much as the part produced under favorable conditions (and less expense) if the full supply is to be forthcoming.

There can be only one price in a market at one time: this is an axiom of economics. And if this price is to be fixed with any idea of bringing in the needed supply, the most expensive part of its production must be allowed for.

This most expensive part is the marginal supply. It is true that there will be a profit, possibly a large one, on the infra-marginal portions produced under the more favorable conditions. But this cannot be avoided so long as industry is privately operated. And even if industry were not privately operated, this surplus would still appear, though it would not be disbursed to private individuals as dividends; there would still be a marginal portion and infra-marginal portions as long as there were different costs of production per unit of product. It might be noted in passing that this infra-marginal profit, or producers' surplus as it is sometimes called, is reachable under income taxes so that, although the consumer contributes to the producers' surplus, this surplus may be tapped to assist in paying for the expenses of government, thus reducing the taxes consumers would otherwise have to pay. The producers' surplus is the social fund which supports civilization and adds to the richness of economic life, whether industry be privately or publicly owned.

The determination of the supply needed is the starting point; and this must be followed by a study of comparative producing expenses to determine just where the margin of production lies. Once this margin is discovered a price may be set which will cover the marginal expense and allow the current and customary rate of profit. This should serve to call out the needed supply. If it does not, the regulating body will be forced to raise the profit incentive; or if this fails within reasonable limits, it may be forced to recommend to the state that it take over and itself operate the industry.

The determination of the needed supply involves difficult social measurements, as such regulating bodies as state utilities commissions and the Interstate Commerce Commission have had occasion to discover.

There arises at the very beginning an almost insuperable difficulty. Who is to say how much of any good or service is needed? Shall the figures of past consumption be taken as a guide? Or shall new and more ideal conditions be forecast and consumption needs be estimated in the new environment? This is merely the contrast between expert judgment and mass judgment. If one's bias is toward democracy in the determination of living standards, deductions from the statistics of past consumption will be sufficient; but if one feels that most people are ill-prepared to assume the responsibility of social living, that they live unwisely and too well (or too poorly), he will not care to be guided by past experience. He will desire a new set of criteria.

So, it may be seen, there are difficulties even in the determination of what is needed, of how great a supply is desirable, quite aside from all the difficulties involved in accuracy of judgment as to what will happen when consumers are faced with new conditions. There is probably no one answer to this question, but it may be suggested that unless a regulating commission is prepared to enforce its desires upon consumers as well as upon producers, it has no other alternative than to be guided by the facts of past consumption by these same consumers. For their habits and predilections will not greatly change in any short period.

There is one large guiding principle left for it: that it must constantly endeavor to have price really represent the favor in which certain goods and services are held by nature. This principle has been referred to before. Price, under a purely competitive regime, would be representative of the advantage or disadvantage of producing; under the influence of monopoly, price ceases to represent anything of the sort. It becomes the tool of the monopolist. Regulation will not be successful that does not perceive and hold to a system of prices which represents this natural determination.

The difficulties of regulation are therefore twofold; to see that the necessary supply is provided, involves a study of consumption habits under various conditions; and to see that price does not vary greatly from the norm that it would follow naturally, involves study of producing expenses under various other conditions. These two principles may conflict and may require delicate adjusting; but the controlling principle would usually be the attempt to force consumption habits as gently as possible into the channels of least cost, using price as the lever. For people will gradually abandon expensive consumption in favor of cheaper; only there is the danger that certain consumptions are more expensive not because of less aid from nature but because of manipulation of the market by monopolists. For this process of adjustment and insurance against exploitation, the regulating commission is a ready instrument. And in following this principle, although the com-

mission may be the cause of change in consumption habits, the change will not be one which the commission merely believes to be desirable. It makes no war on the predilection and choice of people except such as is determined for it by outside forces. It does not say to people: this or that good is not desirable for you. It simply says, in effect: if you insist on using expensive goods you will have to pay a high price. Then there enters, as the defense of consumers, the power of substitution. And these are the legitimate uses of this power.

Such a commission begins its work by instituting a regular service for the reporting of prices and the volumes of trade at these prices; it thus arrives at a notion of the behavior of its constituency in given situations. When an adequate body of such statistics has been built up it has authority for its estimate of future consumption at different prices under the assumption that vagaries of taste will average out in the long run and that consumers are fairly consistent in their consuming behavior. The study of production costs has to be similarly begun by insistence on uniform accounting methods and standardized reports. And this precedure is made difficult by the growing importance in expanding industries of the phenomenon of joint expenses and of the changing proportions of direct and indirect expenses in the whole volume of expense; but it can be accomplished by the taking of infinite pains.

The process of price regulation itself begins with the estimation of needed supplies based on consumption statistics; the regulating body must then allow a price which will bring in the whole of that supply. In doing this accurately, it will be found that the lines of the natural determination of price are being followed; and when actual expenses of production rise, prices will rise and consumption will be lessened. It might be said that a commission charged with price fixing need therefore only consider the expense of producing the supply and that the principle of the adjustment of price to natural determination will follow; but this might or might not be true. Price fixing is a human procedure and the results of departure from the natural norm though sure and costly are not immediately apparent. Consumers might very conceivably bring pressure to bear to keep down the price of what are considered necessities. The principle for this reason has to be kept in mind as the ultimately most important; although the immediate reason for price fixing is usually reaction from the arbitrary exploitation of consumers.

The commission form of regulation has been referred to; and as a general rule it seems superior to the method of fixing prices in the statutes of legislatures because of the inflexibility of a price fixed once and for all. Inflexibility might very easily defeat the aims of price fixing. A commission with power to regulate may, from time to time, at indefinite intervals and as often as need be, readjust rates to con-

form to changing conditions of expense in producing or of habits of consuming; or to shiftings of particular prices relative to the general level of price movements. And all of these seem necessary to really successful regulation.

The objection to regulation so often made, that the expense of regulating is greater than the savings, has been referred to. This may very well be a valid objection unless the functions of a regulating commission are performed with care and accuracy and with a sure knowledge of the results desired. It is sometimes urged as a failure of democracy that it blunders into and through whole social policies without adequate study and evaluation and without any sufficiently definite conception of the results that are desired.

The Sherman Anti-trust act and the Clayton act cannot be said to have been highly successful as we review their results. The regulation of businesses affected with a public interest, a method of control becoming more and more important, is another attempt to make the necessary contact of politics with industry; its protagonists feel it to be conceived, in contrast with the anti-trust acts, both more constructively and less repressively and to have a greater chance for success. But that chance ought to be discussed thoroughly and weighed well before embarkation on the policy is begun. It is perhaps, too late for that; the policy is already in wide-spread operation. But the aims and difficulties still to be defined and met are many and more discussion is needed. The legislatures have shown a disposition to apply the rule of regulation piecemeal and haphazard in emergency situations with a remainder of half-hearted regulation after the emergency has passed, rather than any desire to consider well and extend the policy experimentally to determine its advantages and its dangers. This can hardly be said to be good statesmanship. And the courts, in betraying a defiant attitude toward what they call "economic theory," have given the impression sometimes that such regulations of modern business as they approve are contrary to accepted economic opinion. But it is economics, as a matter of fact, that provides the theoretical basis for such regulations. The tendency to increasing returns in certain modern industries is not a new dynamic generalization; nor is it only recently that economists have discovered that competition is not always present in the market to protect consumers. When it is not present and buyers are subjected to "oppression," there exists a situation—and an economic situation—in which the state not only may legitimately interfere in the public interest, but, indeed, must interfere, if serious and widespread consequences in restricted consumption and lowered morale are not to be incurred.

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